Economic Outlook

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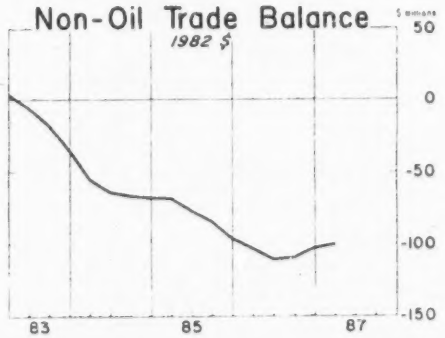
Recently released economic indicators are consistent with our forecast of moderate growth in the second quarter. Average retail sales in April and May were 1.6% higher than in the first quarter. This suggests that, after two consecutive quarters of declines, consumer spending will again contribute positively to economic growth. The latest capital spending survey, conducted in April and May, indicated that businesses plan to increase their investment expenditures sharply this quarter. This survey result is confirmed by the rise in civilian capital goods orders in recent months. The continued increases in military orders since February also suggest that the anticipated slowdown in defense spending will probably not occur until the second half of this year. On the other hand, inventory investment will drop sharply, cutting overall growth well below the first quarter's 4.8%.

In the second half of this year final sales are expected to continue to grow, while inventory investment seems unlikely to be reduced further. Excessive auto inventories may continue to pose problems, but any further reductions in auto inventories will likely be offset by restocking in other industries. As a result, real GNP growth is forecast to average 3 1/2% in the final two quarters of this year. Although in nominal terms our trade deficit began to stabilize only recently, as the following chart shows, in volume terms our non-oil trade deficit has narrowed since mid-1986. This improvement, which has been contributing an average of 1/2% to real GNP growth in the last three quarters, will likely accelerate in view of the further depreciation of the dollar early this year.



The extremely low savings rate in April has caused concerns over the sustainability of consumer spending growth. However, it should be noted that the low savings rate in April was due to large tax payments on capital gains realized in late 1986 when investors rushed to unload their portfolios in order to take advantage of the more favorable tax treatment for capital gains under the old tax law. Therefore, as those taxes most likely were not paid out of current income but rather from money set aside at the time when capital gains were realized, the low savings rate in April overstated how stretched consumers really are. The consistent rise in consumer confidence (measured by the Conference

(Continued)

Board index) since the beginning of this year further indicates that moderate consumer spending increases will be maintained for the remainder of this year. Improved profitability and enhanced sales prospects as a result of lessened foreign competition may also induce U.S. business to spend more on capital investment. On the other hand, higher interest rates may be a drag on investment. But since the rise in rates should mainly reflect heightened inflationary expectations, the negative effect of higher nominal rates on investment should be small as real interest rates remain unchanged.

After hovering around 7% for most of 1985 and 1986, the unemployment rate has dropped considerably in recent months. The current national unemployment rate of 6.3% is the lowest since the beginning of this decade. An all-time high employment/population ratio of 62% provides further evidence of a tightening labor market. The recent improvement in the labor market, however, was unevenly distributed within the nation. The Northeast corridor--from Washington, D.C. to Boston--showed the greatest improvement, while the oil-producing states in the Southwest and Alaska remained depressed.

Victor Kung

Real GNP

(Percent Contribution to Real GNP Growth; Annual Rates)	Actual				Forecast				Actual	Forecast	
			1986	1987			1987	1988	1985-	1986-	1987-
	II	III	IV	I	II	III	IV	I	1986	1987	1988
Consumer Spending	4.0	4.4	-0.2	-0.8	2.1	2.0	1.7	1.3	2.6	1.3	1.5
Business Investment	-0.1	-0.3	0.4	-1.2	0.8	0.2	0.3	0.3	-0.1	-0.1	0.4
Residential Investment	0.6	0.5	0.3	-0.3	0.0	-0.2	-0.2	-0.1	0.5	0.1	0.0
Change in Inventories*	-2.9	-2.4	-0.4	4.8	-2.6	0.2	0.3	0.3	-0.2	0.2	0.0
Net Exports	-3.0	-1.0	1.6	1.6	1.0	1.0	0.9	0.5	-1.1	0.6	0.6
Government Purchases*	2.0	1.6	-0.6	0.7	0.7	0.5	0.5	0.5	0.8	0.7	0.5
Real GNP	0.6	2.8	1.1	4.8	2.0	3.7	3.5	2.8	2.5	2.8	3.0

Quarterly Economic Indicators

(Percent Changes at Annual Rates)	Actual				Forecast				Actual	Forecast	
			1986	1987			1987	1988	1985-	1986-	1987-
	II	III	IV	I	II	III	IV	I	1986	1987	1988
Nominal GNP	2.6	6.4	1.7	9.1	6.3	8.0	8.1	7.8	5.2	6.2	8.1
GNP Deflator	1.8	3.6	0.7	4.2	4.1	4.1	4.5	4.9	2.7	3.3	4.9
Corporate Profits After Tax#	1.7	1.9	3.7	9.4	11.7	7.2	1.8	7.0	2.0	7.3	5.4

Monthly Economic Indicators

	Recent Data			Actual	Forecast	
	Mar.	Apr.	May	1986	1987	1988
Consumer Price Index** (%)	0.4	0.4	n.a.	1.1	5.1	6.0
Industrial Production (%)	0.0	-0.1	0.5	1.0	2.9	3.5
Retail Sales (%)	0.3	0.2	-0.6	5.5	3.4	5.8
Auto Sales (million units, a.r.)	10.1	10.5	9.8	11.5	10.3	10.0
Housing Starts (million units, a.r.)	1.73	1.67	1.62	1.81	1.67	1.63
Unemployment Rate (%)	6.6	6.3	6.3	7.0	6.3	5.9
Merchandise Trade Deficit ($ bn., a.r.)	-163.2	-159.6	n.a.	-166.3	-155.0	-135.0

*Adjusted for CCC purchases. **Annual percent changes are December to December.
#Quarterly data are year-over-year percent changes.
a.r.=annual rate F=Forecast